

# SIGNIFICANT DEVELOPMENTS

**A**s discussed in Commissioner McQueen's comments in the Bureau's 1997 Annual Report, for the first time since 1988, a state-chartered bank failed. The bank, OmniBank, headquartered in River Rouge, was declared insolvent on April 9, 1998. Importantly, there were no losses to the institution's depositors (See Bank and Trust Division, page 24).

## LEGISLATIVE DEVELOPMENTS

### STATE LEGISLATION ENACTED

**1998 Public Act No. 371** (effective October 20, 1998) amends the Mortgage Brokers, Lenders and Servicers Licensing Act to allow the Commissioner to exempt from licensure or registration requirements a nonprofit corporation that serves limited geographic areas, does not compete with traditional conforming mortgage lenders, demonstrates its programs have the support of a local government housing agency, and administers pools of funds belonging to depository institutions or obtains its funds from the federal government, MSHDA, the Local Initiative Support Corporation, religious or charitable organizations, or other nonprofit organizations. The amendatory act also exempts nonprofit corporations, which make, broker, or service mortgage loans in connection with a neighborhood housing program assisted pursuant to the Neighborhood Reinvestment Corporation Act.

**1998 Public Act No. 372** (effective October 20, 1998) amends the Secondary Mortgage Loan Act to exempt nonprofit corporations that make or service secondary mortgage loans only in connection with mortgages made under the program described in 1998 Public Act No. 371, if the Commissioner has determined that the nonprofit corporation is exempt from the Mortgage Brokers, Lenders and Servicers Licensing Act. The amendatory act also exempts nonprofit corporations, which make, broker, or service secondary mortgage loans made under a neighborhood housing program assisted pursuant to the Neighborhood Reinvestment Corporation Act.

**1998 Public Act No. 455** (effective December 30, 1998) amends the Vehicle Code by prohibiting automobile brokering except by licensed automobile dealers, i.e., those licensed as auction dealers.

**1998 Public Act No. 456** (effective December 30, 1998) amends the Automobile Dealers Franchise Act by prohibiting automobile manufacturers from the following: requiring new car dealers to pay for manufacturers' refunds or rebates, engaging in "arbitrary and capricious" vehicle allocation, requiring certain expensive "essential" service tools

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without a good faith estimate of the number of vehicles to be allocated to the dealer, and from preventing a change in the executive management of a dealer unless the change would result in management by someone who was “not of good moral character” or who did not meet other standards.

**1998 Public Act No. 410** (effective December 21, 1998) amends the Insurance Code of 1956 to exempt companies issuing private mortgage insurance policies from the following requirements: the insurer refund the excess of paid premiums above the pro rata rate upon the cancellation of the policy and the minimum earned premium on a policy not be less than the greater of the pro rata premium for the expired time or \$25.

## FEDERAL LEGISLATION

### FINANCIAL MODERNIZATION

The most widely publicized financial services issue Congress undertook to resolve in the 1997-98 session ultimately was not enacted. HR 10, which would have repealed Glass-Steagall Act provisions separating commercial from investment banking, passed the House by the narrowest of margins (214-213) on May 13, 1998, but stalled late in the year in the Senate Banking Committee over disputes on the application of the Community Reinvestment Act to uninsured wholesale financial institutions. A CRA exemption targeted at small banks also killed Rep. Marge Roukema’s regulatory burden relief bill, HR 4364.

### FEDERAL EXAMINATION FEES ON STATE-CHARTERED BANKS AND HOLDING COMPANIES

At the urging of the Conference of State Bank Supervisors and bank trade associations Congress rejected another Presidential budget

recommendation that would require the FDIC and the Federal Reserve to assess fees for their examinations of state-chartered banks and holding companies. Both the FDIC and the Federal Reserve have been authorized to charge for examinations since 1991, but have chosen not to impose the charges. Currently, the fee structure for state- and federally chartered banks is identical: both pay the primary regulator for examinations and pay deposit insurance premiums to the FDIC. Congress has rejected such fees on five previous occasions.

**PL 105-216** (signed July 29, 1998) requires lenders to notify borrowers of their right to request cancellation of private mortgage insurance (PMI) when equity in a home reaches 20%, and to automatically cancel PMI when equity reaches 22% of the lower of the original purchase price or the appraised value at closing — if the mortgage payments are current. Under the measure, high-risk borrowers can be required to keep PMI coverage until their equity reaches 50%. Loans carrying lender-paid mortgage insurance will trigger a set of disclosures that borrowers do not have a right to cancel this insurance.

The federal act, by its terms, preempts a state law on the subject unless that the law was enacted before July 29, 2000 and the state had a PMI protection law as of January 2, 1998. For states with such laws, only the portions that are inconsistent with the new federal law would be preempted.

**PL 105-219** (signed August 7, 1998), the Credit Union Membership Access Act (CUMAA) overturned a February 25, 1998 Supreme Court decision requiring members of credit unions to share a single common bond. The CUMAA permits a credit union to serve unrelated companies or other groups that have fewer than 3,000 people. In exchange for gaining this authority to offer expanded access, credit unions

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had to accept tighter restrictions on membership and lending and tougher safety and soundness regulations. To implement the 100-page act will require the NCUA to issue many regulations, which may be controversial.

## **BUREAU ISSUANCES**

In 1998 the Bureau issued several position statements and industry bulletins. The position statements and bulletins are available at the Bureau's web site: [www.cis.state.mi.us/fib](http://www.cis.state.mi.us/fib). The first mortgage bulletin, issued on November 12, 1998, addressed the "right of first refusal to provide additional financing," a contractual right to prevent a borrower from refinancing a mortgage without giving the current lender the opportunity to provide the refinancing on substantially similar terms and conditions. The Bureau concluded that it is unlawful in the State of Michigan for a licensee or registrant under the Mortgage Brokers, Lenders and Servicers Licensing Act to use a document purporting to grant to the licensee or registrant the right of first refusal.

The second mortgage bulletin, issued on November 16, 1998, dealt with the legal status of mortgage prepayment penalty restrictions found in the Michigan Usury Statute in light of two federal laws — the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) and the Alternative Mortgage Transaction Parity Act of 1982 ("Parity Act"). With regard to DIDMCA, lenders making loans secured by a first lien on residential property, except for certain alternative mortgage transactions, are barred from charging Michigan consumers prepayment fees outside of those allowed by state law. The limitations on prepayment fees found in the state Usury Statute are preempted by the Parity Act if the lender is a "housing creditor" and the extension of credit is made in compliance with the Parity Act and other applicable regulations.

On December 9, 1998, the Bureau issued a position statement on whether Guaranteed Automobile Protection (GAP) contracts can be financed under the Motor Vehicle Sales Finance Act (act). The Bureau reaffirmed its long-standing position that the cost of a GAP contract cannot be added to the principal amount financed under the act unless the contract is a contract of insurance approved by the Insurance Bureau.

In another position statement issued on March 25, 1998 in response to the recent U. S. Supreme Court ruling in *National Credit Union Administration v. First National Bank & Trust, et al.*, the Bureau emphasized that the decision does not apply to Michigan state-chartered credit unions. The statement noted that the court's ruling is consistent with the Bureau's interpretation of the Michigan Credit Union Act field of membership provisions.

On December 18, 1999, the Bureau issued a letter stating that a national bank that makes mortgage loans to Michigan residents, but which does not maintain a main office, branch office, or service center in Michigan, is not a credit granting institution under the Mortgage Anti-Redlining Act (Act). For purposes of the Act, however, branch office or service center would include a Michigan-based mortgage broker under the control of an out-of-state mortgage lender.

## **FEDERAL ISSUANCES**

### **FEDERAL RESERVE ADOPTS FINAL RULE REVISING REG. H**

The Federal Reserve announced the adoption of a final regulation to revise Regulation H, defining requirements for state-chartered bank membership in the Federal Reserve System. It also established minimum levels for the ratio of capital-to-assets to be maintained by state member banks. The amended regulation reduces the regulatory burden on state member banks by

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liberalizing the criteria under which Fed membership is granted and providing a definition of branch that is consistent with that of the Office of the Comptroller. Specifically, branch now includes temporary, seasonal, or mobile facilities but excludes from the definition loan originating facilities in which loan proceeds are not disbursed, ATMs, and remote service units. The Federal Reserve also rescinded Regulation P, regulating bank security procedures, which the revisions to Reg. H made unnecessary. The final rule took effect October 1, 1998.

### **FDIC STREAMLINES APPLICATION PROCEDURES**

In August 1998, the FDIC Board finalized one of its regulatory relief proposals by simplifying the application procedures and consolidating into a single rule the procedures previously found in different parts of the regulation. Most significantly, applications filed by well-managed and well-capitalized institutions will receive expedited processing. It is estimated that 90% of insured banks will be eligible for expedited processing.

### **ANTI-LAUNDERING PROPOSAL**

The 'know-your-customer' proposal, released in early December of 1998 and intended to discourage money laundering, generated many negative comments from bankers and privacy advocates: by year-end, the Federal Reserve had received nearly 350 letters, the FDIC (owing to its acceptance of comments filed by e-mail) more than 6,600, and the OCC about 425 letters. Critics of the proposal charge that it would violate customers' civil liberties, turn bankers into police officers, and would be costly to implement. Regulators countered that the proposal is not really new (that banks already have policies in place to identify unusual activity) and it was intended to provide flexibility to the bank.

### **THRIFT BUSINESS LENDING RULE**

New government regulations permit federal thrifts to lend twice as much (in aggregate) to commercial borrowers. Under the new rules, a federal thrift may lend up to 20% of its assets to commercial customers but half of such loans must be made to small businesses (defined as loans not in excess of \$1 million). Also, the new regulations permit all education, small business, and credit card loans to count in meeting the qualified thrift lender test.

### **GUIDELINES ON THE USE OF TRADE NAMES**

Federal banking agencies advised their respective institutions to adopt procedures intended to help customers recognize that different facilities of an institution, including an Internet site, are not separately insured merely because they operate under different names. The guidelines set forth in an Interagency Statement on Branch Names recommend:

- clearly and conspicuously disclosing in signs, advertising, and related materials that the facility is a branch of the institution;
- using the legal name of the institution for legal documents, CDs, signature cards, loan agreements, account statements, and similar documents;
- educating the institution's staff about the possibility of customer confusion over deposit insurance; and
- requesting depositors opening new accounts to sign a statement acknowledging that the institution informed them that the facility is part of the institution and deposits at each are not separately insured.

There are no federal laws or regulations which require that branches or Internet sites operate under a single name. The guidelines took effect July 1, 1998.

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## **SEC INTERPRETIVE LETTER ON Y2K DISCLOSURES**

The Securities and Exchange Commission has published guidance for publicly traded companies (including financial institutions), investment advisors, investment companies, and municipal securities issuers on their disclosure obligations for Y2K. The interpretive letter provides guidance to help companies to determine which issues they should disclose in the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” part of their disclosures. Under the directive, if a company determines that it has a Y2K disclosure obligation, it must address four categories of information: the company’s state of readiness, costs to address its Y2K problems, its Y2K risks, and its contingency plans. The interpretive letter warns companies that any materially false and misleading statements or omissions will trigger the anti-fraud provisions of the federal securities laws. The interpretive letter took effect August 4, 1998.

## **FDIC Y2K CONSUMER BROCHURE**

The FDIC has published a consumer brochure, in English and Spanish, on Y2K. Working with trade associations, the FDIC has provided institutions with 3.5 million copies of this brochure and it is available at the FDIC web site (see [www.FDIC.gov](http://www.FDIC.gov)).

## **ADVISORY ON “PRETEXT PHONE CALLING”**

After working with the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the Federal Reserve Board, the Federal Bureau of Investigation, the Secret Service, and the Internal Revenue Service, the Office of the Comptroller of the Currency issued an advisory letter on August 20, 1998, on “pretext phone calling.” Pretext phone calling is a way in which organizations and individuals calling themselves “account

information brokers” call a financial institution pretending to be a customer in order to induce an employee of the institution to provide account information. The account information broker, in turn, sells the information to third parties to use in lawsuits or to identity thieves who may use the information for fraudulent purposes.

The advisory letter noted that using fraudulent practices to obtain customer account information may violate state and federal deceptive practices laws and federal wire fraud laws.

To ensure that national banks do not improperly disclose customer information, the letter recommends that they develop policies and procedures on financial information privacy. The policies and procedures should address such issues as

- the release of information over the telephone;
- the use of a caller identification service or ask the caller for the number from which he or she is calling;
- conduct of unscheduled test pretext phone calls to bank departments in order to evaluate the institution’s performance;
- employee training about the importance of protecting personal account information; and
- prompt reporting of suspected illegal attempts to obtain customer information.

## **FDIC OPINION ON INTEREST RATE EXPORTATION**

On May 13, 1998, the FDIC General Counsel issued an opinion giving multi-state state-chartered banks flexibility to export interest rates from virtually any state. This authority provides state banks parity with national banks.

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## **LITIGATION**

### **STATE — TONYA L. KRAUSE AND LAWRENCE PHELAN ET AL. V. THE HUNTINGTON NATIONAL BANK**

On July 23, 1998, Kent County Circuit Court Judge Paul J. Sullivan granted defendant Huntington National Bank's motion for Summary Disposition in a case (Tonya L. Krause and Lawrence Phelan v. The Huntington National Bank) alleging that the bank engaged in the unauthorized practice of law by charging mortgage borrowers a fee for document preparation. Judge Sullivan ruled that a non-lawyer party (bank) is not barred from representing itself, i.e., the prohibition against practicing law applies only to the practice of law for persons other than itself. The judge reasoned that the bank preparing the documents (adjustable rate note and mortgage) relied on them to protect its security. The case has not been appealed.

### **FEDERAL — PATRICK M. MCQUEEN V. EUGENE A. LUDWIG**

As reported in detail in the Bureau's 1997 annual report, the Commissioner brought an action challenging a decision of the Comptroller of the Currency on three applications of Society Bank, Michigan, Ann Arbor and Society National Bank, Indiana, South Bend. The Commissioner filed suit in U.S. District Court for the Western District of Michigan, Southern Division arguing that the action of the Comptroller violated the National Bank Act.

The Court declined to set aside the January 5, 1996 decision based on the Comptroller's conclusion that the converting bank could designate an existing branch as the main office of the converted national bank. The Bureau has filed an appeal of the Court's decision with the U.S.

Court of Appeals for the Sixth Circuit in Cincinnati. The oral argument was held in September 1998 and the Bureau is awaiting a decision.